MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Good afternoon, the Vice-President and I welcome you to our press conference.

We would like to begin by congratulating Croatia on joining the euro area on 1 January 2023. We also warmly welcome Boris Vujčić, the Governor of Hrvatska narodna banka, to the Governing Council. We will now report on the outcome of today's meeting.

The Governing Council will stay the course in raising interest rates significantly at a steady pace and in keeping them at levels that are sufficiently restrictive to ensure a timely return of inflation to our two per cent medium-term target. Accordingly, the Governing Council today decided to raise the three key ECB interest rates by 50 basis points and we expect to raise them further. In view of the underlying inflation pressures, we intend to raise interest rates by another 50 basis points at our next monetary policy meeting in March and we will then evaluate the subsequent path of our monetary policy. Keeping interest rates at restrictive levels will over time reduce inflation by dampening demand and will also guard against the risk of a persistent upward shift in inflation expectations. In any event, our future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach.

The Governing Council today also decided on the modalities for reducing the Eurosystem's holdings of securities under the asset purchase programme (APP). As communicated in December, the APP portfolio will decline by €15 billion per month on average from the beginning of March until the end of June 2023, and the subsequent pace of portfolio reduction will be determined over time. Partial reinvestments will be conducted broadly in line with current practice. In particular, the remaining reinvestment amounts will be allocated proportionally to the share of redemptions across each constituent programme of the APP and, under the public sector purchase programme (PSPP), to the share of redemptions of each jurisdiction and across national and supranational issuers. For our corporate bond purchases, the remaining reinvestments will be tilted more strongly towards issuers with a better climate performance. Without prejudice to our price stability objective, this approach will support the gradual decarbonisation of the Eurosystem's corporate bond holdings, in line with the goals of the Paris Agreement.

The decisions taken today are set out in a press release available on our website. The detailed modalities for reducing the APP holdings are described in a separate press release to be published at 15:45 CET.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

According to Eurostat's preliminary flash estimate, the euro area economy grew by 0.1 per cent in the fourth quarter of 2022. While above the December Eurosystem staff projections, this outcome means that economic activity has slowed markedly since mid-2022 and we expect it to stay weak in the near term. Subdued global activity and high geopolitical uncertainty, especially owing to Russia's unjustified war against Ukraine and its people, continue to act as headwinds to euro area growth. Together with high inflation and tighter financing conditions, these headwinds dampen spending and production, especially in the manufacturing sector.

However, supply bottlenecks are gradually easing, the supply of gas has become more secure, firms are still working off large order backlogs and confidence is improving. Moreover, output in the services sector has been holding up, supported by continuing reopening effects and stronger demand for leisure activities. Rising wages and the recent decline in energy price inflation are also set to ease the loss of purchasing power that many people have experienced owing to high inflation. This, in turn, will support consumption. Overall, the economy has proved more resilient than expected and should recover over the coming quarters.

The unemployment rate remained at its historical low of 6.6 per cent in December 2022. However, the rate at which jobs are being created may slow and unemployment could rise over the coming quarters.

Government support measures to shield the economy from the impact of high energy prices should be temporary, targeted and tailored to preserving incentives to consume less energy. In particular, as the energy crisis becomes less acute, it is important to now start rolling these measures back promptly in line with the fall in energy prices and in a concerted manner. Any such measures falling short of these principles are likely to drive up medium-term inflationary pressures, which would call for a stronger monetary policy response. Moreover, in line with the EU's economic governance framework, fiscal policies should be oriented towards making our economy more productive and gradually bringing down high public debt. Policies to enhance the euro area's supply capacity, especially in the energy sector, can help reduce price pressures in the medium term. To that end, governments should swiftly implement their investment and structural reform plans under the Next Generation EU programme. The reform of the EU's economic governance framework should be concluded rapidly.

Inflation

According to Eurostat's flash estimate, which has been calculated using Eurostat estimates for Germany, inflation was 8.5 per cent in January. This would be 0.7 percentage points lower than the December figure, with the decline owing mainly to a renewed sharp drop in energy prices. Market-based indicators suggest that energy prices over the coming years will be significantly lower than expected at the time of our last meeting. Food price inflation edged higher to 14.1 per cent, as the past surge in the cost of energy and of other inputs for food production is still feeding through to consumer prices.

Price pressures remain strong, partly because high energy costs are spreading throughout the economy. Inflation excluding energy and food remained at 5.2 per cent in January, with inflation for non-energy industrial goods rising to 6.9 per cent and services inflation declining to 4.2 per cent. Other indicators of underlying inflation are also still high. Government measures to compensate households for high energy prices will dampen inflation in 2023 but are expected to raise inflation once they expire. At the same time, the scale of some of these measures depends on the evolution of energy prices and their expected contribution to inflation is particularly uncertain.

Although supply bottlenecks are gradually easing, their delayed effects are still pushing up goods price inflation. The same holds true for the lifting of pandemic-related restrictions: while weakening, the effect of pent-up demand is still driving up prices, especially in the services sector.

Wages are growing faster, supported by robust labour markets, with some catch-up to high inflation becoming the main theme in wage negotiations. At the same time, recent data on wage dynamics have been in line with the December Eurosystem staff projections. Most measures of longer-term inflation expectations currently stand at around two per cent, but these warrant continued monitoring.

Risk assessment

The risks to the outlook for economic growth have become more balanced. Russia’s unjustified war against Ukraine and its people continues to be a significant downside risk to the economy and could again push up the costs of energy and food. There could also be an additional drag on euro area growth if the world economy weakened more sharply than we expect. Moreover, the recovery would face obstacles if the pandemic were to re-intensify and cause renewed supply disruptions. However, the energy shock could fade away faster than anticipated and euro area companies could adapt more quickly to the challenging international environment. This would support higher growth than currently expected.

The risks to the inflation outlook have also become more balanced, especially in the near term. On the upside, existing pipeline pressures could still send retail prices higher in the near term. Moreover, a stronger than expected economic rebound in China could give a fresh boost to commodity prices and foreign demand. Domestic factors such as a persistent rise in inflation expectations above our target or higher than anticipated wage rises could drive inflation higher, also over the medium term. On the downside, the recent fall in energy prices, if it persists, may slow inflation more rapidly than expected. This downward pressure in the energy component could then also translate into weaker dynamics for underlying inflation. A further weakening of demand would also contribute to lower price pressures than currently anticipated, especially over the medium term.

Financial and monetary conditions

As we tighten monetary policy, market interest rates are rising further and credit to the private sector is becoming more expensive. Bank lending to firms has decelerated sharply over recent months. This partly stems from lower financing needs for inventories. But it also reflects weakening demand for loans to finance business investment, in the context of a steep upward move in bank lending rates and a considerable tightening in credit standards, which is also visible in our most recent bank lending survey. Household borrowing has continued to weaken as well, reflecting rising lending rates, tighter credit standards and a sharp fall in the demand for mortgages. As loan creation decelerates, money growth is also slowing rapidly, with a marked decline in its most liquid components, including overnight deposits, only partially compensated by a shift to term deposits.

Conclusion

Summing up, the Governing Council will stay the course in raising interest rates significantly at a steady pace and in keeping them at levels that are sufficiently restrictive to ensure a timely return of inflation to our two per cent medium-term target. Accordingly, we today decided to raise the three key ECB interest rates by 50 basis points and we expect to raise them further. In view of the underlying inflation pressures, we intend to raise interest rates by another 50 basis points at our next monetary policy meeting in March and we will then evaluate the subsequent path of our monetary policy. Keeping interest rates at restrictive levels will over time reduce inflation by dampening demand and will also guard against the risk of a persistent upward shift in inflation expectations. Moreover, from the beginning of March 2023, the APP portfolio will decline at a measured and predictable pace, as the Eurosystem will not reinvest all of the principal payments from maturing securities.

Our future policy rate decisions will continue to be data-dependent and determined meeting by meeting. We stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term target.

We are now ready to take your questions.

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I was wondering if you could tell us a little bit about the flavour of the debate that preceded today's decision to raise interest rates by 50 basis points in March? I'm interested in knowing whether there were any calls to commit for longer, potentially flag a less aggressive stance, or say nothing at all, given that you also say that your decisions are data-dependent. That would be my first question.

The second one, I'm interested, when you say the subsequent policy path will be decided in March, are we just talking about the pace of rate increases, or could one potential conclusion also be that you have already reached the peak in interest rates at that time?

Those are really good questions to try to explain our decision. I would just remind you that our decision is not the decision for March. We're taking a decision as of now, which is to raise all three interest rates by 50 basis points. I would characterise our good discussions with an enlarged Governing Council, given that we are now 26 around the table, I would characterise them as marked by the sign of continuity and consistency. I know that I have repeated that in the course of the monetary policy statement, and I have said it before, but the expression, 'We shall stay the course', or 'the Governing Council will stay the course', is a good way to express that double principle of continuity and consistency. Continuity, because we were very clear in December that in all reasonable scenarios significant rate increases would be needed. Would be needed for what? To bring inflation back to the 2% medium-term objective that we have in a timely manner.

We also made it clear that this would require rates to rise to sufficiently restrictive levels, and that rate increases would happen at a steady pace. So we are making that decision in that continuity that I have tried to explain. Steady pace: we increased rates by 50 basis points in December, we increased rates by 50 basis points in early February, and we intend – which is a strong word; it's not an absolute, irrevocable, unconditional commitment, but it's a strong word – we intend to raise by 50 basis points, and that is what was meant in December by this steady pace reference that you find, yet again, in the